

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

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Date:

November 16, 2006

## Legend:

Acquiring =

Sub =

Target =

State x =

Date 1 =

Date 2 =

Date 3 =

m =

n =

p =

Dear :

This letter responds to your August 10, 2006 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in later correspondence is summarized below.

### **Summary of Facts**

Acquiring, Sub, and Target each are corporations of State x. Acquiring owned approximately m% of the stock of Target and approximately n% of Sub. Sub owned approximately p% of Target.

Acquiring, as of Date 1 elected to be a subchapter S corporation. On Date 2, Acquiring and Sub entered into a Plan of Stock Exchange under the laws of State x (the "Stock Exchange"). Pursuant to the Stock Exchange, the stockholders of Sub exchanged their shares in Sub for shares in Acquiring. As a result, Sub became a wholly owned subsidiary of Acquiring. Effective as of Date 3, Acquiring made an election to treat Sub as a qualified subsidiary (Qsub). Acquiring represents that the Stock Exchange followed by the Qsub satisfied the requirements of § 368(a)(1)(D) of the Internal Revenue Code (the Code).

For valid business purposes, including facilitating a more efficient operating structure, Target will also become a Qsub of Acquiring.

### **The Proposed Transaction**

To accomplish these business purposes, the following transaction is proposed (the Proposed Transaction):

(i) Acquiring and Target will enter into a Plan of Stock Exchange under the laws of State x. Each outstanding share of Target will be exchanged for one share or correspondingly fractional share of Acquiring.

(ii) Any Target shareholder who does not want to exchange Target stock for Acquiring stock, or who would be an ineligible shareholder of a subchapter S corporation, will receive cash from Acquiring.

(iii) Immediately following the Stock Exchange, Acquiring will make an election to treat Target as a Qsub.

### **Representations**

In connection with the Proposed Transaction it has been represented that:

- a. The fair market value of the Acquiring stock and other consideration received by each Target stockholder will be approximately equal to the fair market value of the Target stock surrendered in the exchange.
- b. Acquiring will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Target immediately prior to the Proposed Transaction. For purposes of this representation, amounts paid by Target to dissenters, amounts used by Target to pay its reorganization expenses, amounts paid by Target to shareholders who receive cash or other property, and all redemptions and distributions (except for regular normal dividends) made by Target immediately preceding the transfer will be included as assets of Target immediately prior to the Proposed Transaction.
- c. Following the Proposed Transaction, the stockholders of Target will be in control of Acquiring within the meaning of § 368(a)(2)(H).
- d. There is no plan or intention by the shareholders of Target to sell, exchange, or otherwise dispose of shares of Acquiring stock.
- e. Acquiring has no plan or intention to reacquire, directly or through a related person, any of its stock issued in the Proposed Transaction.
- f. Acquiring has no plan or intention to sell or otherwise dispose of any of the assets of Target acquired in the Proposed Transaction, except for dispositions made in the ordinary course of business.
- g. The liabilities of Target assumed by Acquiring (as determined under § 357(d)) were incurred by Target in the ordinary course of its business and are associated with assets transferred.
- h. Following the Proposed Transaction, Acquiring will continue the historic business of Target or use a significant portion of Target's historic business assets in a business.
- i. At the time of the Proposed Transaction, Acquiring will not have outstanding any warrants, options, convertible securities, or any other type of right pursuant to which any person could acquire stock in Acquiring that, if exercised or converted, would affect the acquisition or retention of control (as defined in § 368(a)(2)(H)).

- j. Acquiring, Target, and the stockholders of Target will each pay their respective expenses, if any, incurred in connection with the Proposed Transaction.
- k. There is no intercorporate debt existing between Acquiring and Target that was issued, acquired, or will be settled at a discount.
- l. No two parties to the transaction are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- m. The fair market value of the assets of Target transferred to Acquiring will equal or exceed the sum of the liabilities to be assumed by Acquiring.
- n. Target is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

### **Rulings**

Provided that a valid Qsub election was made for Target, based on the information submitted and on the representations set forth above, we rule as follows:

1. The Stock Exchange between Target and Acquiring, followed by the Qsub election made by Acquiring on behalf of Target, will be a reorganization within the meaning of 368(a)(1)(D) of the Code. Acquiring and Target will each be “a party to a reorganization” within the meaning of § 368(b).
2. No gain or loss will be recognized by Target upon the transfer of all its assets to Acquiring in exchange for Acquiring stock and the assumption by Acquiring of Target liabilities (§ 361(a) and 357(a)).
3. No gain or loss will be recognized by Target on the distribution of the Acquiring stock to its shareholders (§ 361(c)(1)).
4. No gain or loss will be recognized by Acquiring upon its receipt of the assets of Target in exchange for Acquiring stock (§ 1032(a)).
5. The basis of the Target assets in the hands of Acquiring will be the same as the basis of such assets in the hands of Target immediately prior to the transfer (§ 362(b)).
6. The holding period of Target’s assets in the hands of Acquiring will include the period during which such assets were held by Target (§ 1223(2)).

7. No gain or loss will be recognized by the Shareholders of Target upon their receipt of the Acquiring stock in exchange for their Target stock as described above (§ 354(a)(1)).

8. The basis of the shares of the Acquiring stock received by the Target shareholders will be the same as their basis in the Target stock surrendered in exchange therefor (§ 358 and § 1.358-2).

9. The holding period of the Acquiring stock received by the Target shareholders will include the holding period of the Target stock surrendered in exchange therefore, provided that the Target stock is held as a capital asset on the date of the exchange (§ 1223(1)).

10. As provided in § 381(a), Acquiring will succeed to and take into account the items of Target described in § 381(c), subject to the provisions and limitations of §§ 381, 382, 383, and 384.

### **Caveats**

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any material submitted in support of the request for rulings, it is subject to verification on examination.

No opinion is expressed or implied about the tax treatment of the Proposed Transaction under other provisions of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not expressly covered by the above rulings. In particular, no opinion is expressed (i) about the cash payments made to dissenters or ineligible shareholders of an S corporation and (ii) the validity of the Qsub election made by Acquiring on behalf of Target.

The ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Each taxpayer involved in this transaction should attach a copy of this ruling letter to the taxpayer's federal income tax return for the taxable year in which the transaction is completed. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

In accordance with the power of attorney on file in this office, a copy of this ruling letter will be sent to your authorized representative.

Sincerely,

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Lewis K Brickates  
Chief, Branch 4  
Office of Associate Chief Counsel (Corporate